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The “Place of Effective Management” as a Connecting Factor for Companies’ Tax Residence Within the EU vs. the Freedom of Establishment: The Need for a Rethinking?

by Luca Cerioni*

A. Introduction

The determination of the tax residence of companies – as a fundamental issue of (international) tax law – emerged between the end of the 19th century and the start of the 20th century. This emerged as an issue in cases where companies which were found to have their place of management, in the sense of a decision-making centre, in the United Kingdom (UK), carried out all their business activity, in terms of production and commercialization, in another country. At a time when the UK was establishing its tax system earlier than other countries, the tax courts of this country began to develop the “central management and control test” as a test for establishing companies' tax residence in these situations and to consider the companies at stake as tax residents in the UK on the ground that their decision-making centre was located there.¹ Such decisions appeared to have been driven by an interest to prevent companies carrying out their business abroad from escaping UK taxation on their worldwide income,² and thus to have been motivated by a specific anti-avoidance purpose.³ Nonetheless, the “central management and control” test formed the basis of the “place of effective management” test which, under the Organization for Economic Cooperation and Development (OECD) Model for bilateral conventions against double taxation,⁴ is currently adopted as a tiebreaker rule, *i.e.* as a criteria for allocating the tax residence of companies in cases where both contracting

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¹ ANGHARAD MILLER, LYNNE OATS, & B. BUS, *PRINCIPLES OF INTERNATIONAL TAXATION* 54 (2009).

² Giovanni Moschetti, *Origine storica, significato e limiti di utilizzo del place of effective management, quale criterio risolutivo dei casi di doppia residenza delle persone giuridiche*, 2 *NEOTEPA* 31, 37 (2009).

³ Although such a purpose was not stated at that time.

⁴ OECD MODEL TAX CONVENTION ON INCOME AND CAPITAL (2010). This Model, which represents a non-binding set of guidelines for countries entering into bilateral conventions, first adopted by the OECD in 1963 and periodically updated, is widely taken as a reference by both EU and extra-EU countries. The bilateral conventions against double taxation will be referred to, hereinafter, as “double tax conventions.”

States consider a company as resident under their own domestic law,⁵ and which is also used, as one amongst alternative connecting factors for corporate tax residence, by a number of European Union (EU) Member States under their domestic law.⁶ In turn, the allocation of corporate tax residence to a country allows the State at issue to tax the company on its worldwide income, thereby representing a factor of utmost importance for the attribution of taxing rights.

Given the historical background of the place of effective management” criterion as described above, the present article analyzes whether the application of such a connecting factor for determining companies' tax residence by EU Member States is consistent with companies' freedom of establishment throughout the EU recognized by Articles 49 and 54 of the Treaty on the Functioning of the European Union (TFEU), or whether the objective itself of this fundamental freedom would indicate the need for a rethinking of the tie-breaker connecting factor for corporate tax residence within the EU.

In the author's view, there are a number of reasons for raising this issue, and for attempting to find a possible response. Firstly, the application of the “place of effective management” connecting factor – in the event of companies moving their business activity from the origin State to other EU countries – attracts the tax residence back to the Member State of origin when those companies keep their decision-making centre there; this could arguably be regarded as a restrictive effect. However, the European Court of Justice (ECJ) has repeatedly stated, in its direct tax rulings, that the TFEU's provisions on freedom of establishment – in addition to requiring the host Member State to treat foreign nationals and companies in the same way as its own nationals – also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or companies⁷. The ECJ has taken this position while recognizing the legitimacy of restrictions on this freedom for preventing abusive practices, *i.e.* “transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law.”⁸ These transactions should be taken into account in providing a response to the issue.

Secondly, the academic tax literature has been devoting much attention to another issue raised by the ECJ case law, namely, the compatibility of exit taxes levied by individual Member States in connection with the *transfer* of the tax residence of taxpayers to other

⁵ *Id.*

⁶ This is the case of France, Germany, Hungary, Italy, the Netherlands, Poland, Slovenia and Spain, in addition to the UK.

⁷ See *e.g.*, Case C-264/96, *ICI*, 1998 ECR I-4695, para. 21; Case C-446/03, *Marks & Spencer*, para. 31.

⁸ See *e.g.*, Case C-212/97, *Centros*, 1999 ECR I-1459, para. 24; Case C-321/05, *Kofoed*, 2007 ECR I-5795, para. 38.

Member States.⁹ Whilst this other theme is also of utmost importance, the compatibility with art. 49 and 54 of TFEU of a connecting factor determining the "attraction" of the tax residence back to a country from which a company wishes to operate an outbound transfer can be regarded as preliminary to the discussions about exit taxes. This is because no such taxes are levied as long as the application of a connecting factor prevents the transfer of the tax residence.

Thirdly, according to the author, the issue would be left unresolved even by a potential Directive introducing the Common Consolidated Corporate Tax Base (CCCTB) for multinational groups within the EU. Such a Directive would allow all multinational groups to opt for common rules on the determination of the taxable basis and to the cross-border offsetting of profits and losses of the groups' companies in different countries, and would lead to the sharing of this consolidated tax base amongst Member States according to an apportionment formula. Further, if following the Commission's Proposal¹⁰ in art. 6(4) a directive of this sort would still use the place of effective management as a tiebreaker rule for tax residence allocation, for companies' residents in more than one Member State. Nonetheless, such a provision would only serve to indicate the state in which a parent company could opt for the CCCTB scheme. This would then cause the profit or loss of the parent company to be summed up with profits and losses of all intra-EU subsidiaries for the subsequent apportionment¹¹ of this consolidated tax base amongst the Member States of CCCTB group entities.

Accordingly, the place of effective management as indicated in art. 6(4) of the would-be CCCTB Directive would arguably have a role *different* from allocating to the State of residence the power of worldwide taxation. Last but not least, the OECD itself, from 2001 to 2003, considered possible alternatives to the "place of effective management" and some countries have ceased use of such icebreaker rule.¹²

For the purpose of the overall analysis, this paper is divided into four parts. Part B, after reviewing the contents and the objective of the freedom of establishment, summarizes the concept of abuse of rights as specified by the ECJ case law. In light of the objective of the

⁹ See e.g., Daniele Ascoli, *Exit taxes and fundamental freedoms: the impact of the De Lasteyrie decision on EU member states domestic laws*, 1 DIRITTO E PRATICA TRIBUTARIA INTERNAZIONALE 99 (2006); Michael Lang, *Die gemeinschaftsrechtlichen Rahmenbedingungen für "Exit Taxes" im Lichte der Schlussanträge von GA Kokott in der Rechtsache N*, in STEUER UND WIRTSCHAFT INTERNATIONAL 213-226 (2006); Erik Kemmeren, *Pending Cases Filed by Dutch Courts I: The van Dijk and Bujura Cases*, in ECJ: RECENT DEVELOPMENTS IN DIRECT TAXATION 219-260 (Michael Lang, Joseph Schuch & Claus Staringer eds., 2006).

¹⁰ COM/2011/121/4, Commission's Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)

¹¹ *Id.* at Art. 86.

¹² Giovanni Moschetti, *supra* note 2.

freedom of establishment and of the concept of abusive practices, Part C analyzes the possible friction between the exercise of the right of establishment by companies and the “place of management” connecting factor. Part D formulates a hypothesis about the application of an alternative connecting factor, and conclusive observations follow in Part E.

B. The Freedom of Establishment for Companies and the Concept of Abusive Practice Emerging from the ECJ's Case-law.

1. The Contents and the Objectives of Companies' Freedom of Establishment

Although Art. 54 of the TFEU states that companies governed by national laws of Member States are to be treated in the same way as natural persons, these companies are “creatures of national law” and can only exist in so far as they do not break the connecting factors with the country of incorporation, as the ECJ stated in the landmark 1988 *Daily Mail* ruling.¹³ This ECJ decision clarified that the “right of primary establishment” of individuals, *i.e.* the freedom of individuals under art. 49 to leave the country of origin in order to set up and manage undertakings in another country while keeping their nationality, finds no equivalent in the case of companies, for whom the outgoing transfer of the head office alone, *when breaking the connecting factors required by national law of incorporation for their existence as legal persons*, is not covered by the freedom of establishment.¹⁴ *A contrario*, this was confirmed by the latest ECJ ruling, the 2011 *National Grid* ruling,¹⁵ where the ECJ found that a company which had been incorporated

¹³ Case 81/87, *Daily Mail*, 1988 ECR 5483, para. 19. This ruling was widely commented on by the literature: *inter alia*, Servaas Van Thiel, *Daily Mail Case: Tax Planning and the European Right of Establishment. A Setback*, EUROPEAN TAXATION 357-366 (1988); Otto Sandrock & Andrea Austmann, *Das Internationale Gesellschaftsrecht nach der Daily Mail-Entscheidung des Europäischen Gerichtshofs: Quo vadis?*, RECHT DER INTERNATIONALEN WIRTSCHAFT 249-253 (1989); Boutard Labarde & Marie Chantal, *Chronique de jurisprudence de la Cour de justice des Communautés européennes. Libre circulation des personnes et des services*, JOURNAL DU DROIT INTERNATIONAL 428-431 (1989); Nemesio Vara de Paz, *Traslado de la sede social (sede de dirección) en el ámbito de la Comunidad Económica Europea*, in REVISTA DE INSTITUCIONES EUROPEAS 871-882 (1989); Bernhard Großfeld & Thomas König, *Das Internationale Gesellschaftsrecht in der Europäischen Gemeinschaft*, RECHT DER INTERNATIONALEN IN WIRTSCHAFT 433-440 (1992).

¹⁴ Case 81/87, *Daily Mail*, 1988, *supra* note 13, at para. 24.

¹⁵ Case C-371/10, *National Grid*, 2011. In the situation at stake, the transfer of the place of effective management implied – the ECJ noted – the transfer of tax residence under the UK-Netherlands double tax convention, and the ECJ had to deal with the issue of whether exit taxes imposed by the Netherlands were compatible with the freedom of establishment. The ECJ ruling thus concerned the tax consequences of *the change* of the connecting factor under double tax treaties. This leaves open the different issue – dealt with in this work – about whether the *application of the connecting factor* in itself can create a restriction to the freedom of establishment, when this application attracts the tax residence to a country from which a company operates an outbound transfer (*see infra*, para. 2. and 3).

in the Netherlands and had transferred its place of effective management to the UK without affecting its status as a company incorporated under Netherlands law, was entitled to rely on Arts. 49 and 54. After reaffirming Member States' power to define the connecting factor required of companies for these to be regarded as incorporated under national law and thus as enjoying the right of establishment, the ECJ noted that, in the situation at hand, the company, due to the features of Dutch law, remained validly incorporated in the Netherlands.¹⁶ Whether companies are able to transfer the head office whilst keeping the registered office in the country of incorporation, and enjoying this kind of transfer of protection of Arts. 49 and 54, depends therefore on national law.

Nevertheless, in the 2005 *SEVIC Systems* ruling,¹⁷ the ECJ indicated that the freedom of establishment of companies covers all measures which permit or even merely facilitate access to another Member State by participating in the economic life of the country and recognized that intra-EU mergers are one of the modalities for exercising the freedom of establishment.¹⁸ Subsequently, the contents of the right of primary establishment for companies were further clarified by the ECJ in the 2008 *Cartesio* ruling:¹⁹ the ECJ specified that, except for overriding requirements in the public interest, a Member State cannot prevent a company formed in its jurisdiction from transferring its registered office to another Member State with conversion of its legal form into a new form offered by the State of destination.²⁰ The transfer of the registered office is, by definition, necessary for converting the company's legal form into a new legal form offered by the State of destination. However, *Cartesio* implicitly indicates that a company is entitled to transfer *either* the registered office alone *or* the registered office together with the central administration/head office to another country of the EU.

¹⁶ *Id.* at para. 26-28.

¹⁷ Case C- 411/03, *SEVIC Systems*, 2005 ECR I-10805.

¹⁸ *Id.* at para. 18 and 19.

¹⁹ Case C 210/06, *Cartesio*, 2008 ECR I-9641. Amongst the vast literature on this ruling: Uwe Grohmann, Nancy Gruschinske, *Beschränkungen des Wegzugs von Gesellschaften innerhalb der EU - die Rechtssache Cartesio*, EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 463-464 (2008); Stefan Leible & Jochen Hoffmann, *Cartesio - fortgeltende Sitztheorie, grenzüberschreitender Formwechsel und Verbot materiellrechtlicher Wegzugsbeschränkungen*, BETRIEBS-BERATER 58-63 (2009); Veronika Korom & Peter Metzinger, *Freedom of Establishment for Companies: the European Court of Justice confirms and refines its Daily Mail Decision in the Cartesio Case C-210/06*, 6 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 125-160 (2009); Jan Bohrenkämper, *Corporate Mobility across European Borders: Still no Freedom of Emigration for Companies?*, EUROPEAN LAW REPORTER, 82-92 (2009); Gaetane Goddin & Brice Goddin, *Arrêt "Cartesio": l'étendue de la liberté d'établissement pour les sociétés "émigrantes"*, 157 JOURNAL DES TRIBUNAUX / DROIT EUROPÉEN 77-78 (2009); François Mélin, *Déplacement de siège social dans la Communauté européenne*, 1208 LA SEMAINE JURIDIQUE - ENTREPRISE ET AFFAIRES 2009, 43-45 (2009); Luca Cerioni, *The Cross-border Mobility of Companies within the European Community after the Cartesio Ruling of the ECJ*, THE JOURNAL OF BUSINESS LAW 311-337 (2010).

²⁰ *Id.* at para. 111-112.

It could be assumed that the “central administration”, i.e. “head office”, coincides with the “place of effective management.” Consequently, if the registered office were transferred together with the head office, this transfer would also imply the transfer of the tax residence by virtue of Art. 4 of the double tax conventions based on the OECD Model. The exercise of the freedom of primary establishment would in this case coincide with the transfer of the tax residence under the “place of effective management criteria”. The same outcome would also occur, in light of the *National Grid* ruling, in the case of transfer of the head office alone, only when this transfer is permitted by the national laws of the country of origin. On the contrary, the transfer of the *registered office alone* (accompanied by conversion of the legal form as required by the *Cartesio* ruling) would fall within the scope of the freedom of establishment provisions (when pursuing the objective of these provisions), but it would not imply the transfer of the tax residence under the “place of effective management” criterion.

Consequently, under the dominant interpretation of the “effective place of management” as the place where the main and substantial business decisions are made,²¹ tension could arise where there is transfer to another Member State of the registered office without the head office. In this situation the connecting factor given by the “effective place of management” – which would point to one location of the company for tax purposes – would risk being at odds with the freedom of primary establishment, which would indicate another location.

By contrast, in exercising the “right of secondary establishment”, the company, whilst maintaining its head office in the country in which it was incorporated, would set up in another EU state a subsidiary, a branch, or an agency. Whereas no tax residence issue would arise in the case of creation of a branch or of an agency, the setting up of a subsidiary created in another EU Member State and managed in that State would result (again, under the place of effective management criteria) in the tax residence of this subsidiary being located in the State of its registered office and central administration. In this situation, the exercise of the right of secondary establishment would go on in the same direction as the place of effective management criteria to indicate the tax residence and the location of the company. Nevertheless, if the subsidiary created in another Member State were managed from the State of the parent company, the “effective place of management” criterion would locate the tax residence in a State different from that of the location of the company as resulting from the exercise of the right of secondary establishment.

Arguably, in all situations where the exercise of the freedom of establishment would result in a location different from the location of the tax residence, the connecting factors required for tax residence purposes and their application could be “tested” against the

²¹ Commentary of Article 4 of the OECD Model, para. 24.

objective of the freedom of establishment itself, since the ECJ stated that Member States must exercise their competence in the direct taxation area consistently with EU law²² and provisions granting the freedom of establishment are unconditional.²³

Despite the difference in the contents of the freedom of primary establishment for natural persons as compared to for companies, the ECJ caselaw has made it clear that the objective of the freedom of establishment granted by the Treaty is the same for both categories of taxpayers: it has in fact stated, in a number of rulings concerning both individuals and companies, that this objective is to “assist economic and social interpenetration within the Community in the sphere of activities as self-employed persons”²⁴ and that, accordingly, “freedom of establishment is intended to allow a Community national to participate, on a stable and continuing basis, in the economic life of a Member State other than his State of origin and to profit therefrom”²⁵. By referring to “a Community national”, the ECJ meant to indicate both individuals and companies from any EU Member State. As noted above, it has also recognized that arts. 49 and 54 cover all measures permitting or even merely facilitating access to another Member State through participation in the economic life of the country under the same conditions as *national operators*,²⁶ and that “having regard to that objective of integration in the host Member State, the concept of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period”²⁷. Consequently, the freedom of establishment “presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there”.²⁸

These statements clearly indicate that the objective of economic integration in the Member State of destination, by means of a fixed establishment carrying on indefinitely a genuine economic activity, characterizes the freedom of establishment of both individuals and companies as regards the exercise of either the right of primary or the right of secondary establishment. As a result, the statements could also be sufficient to suggest

²² See e.g., Case C-311/97, *Royal Bank of Scotland*, 1999 ECR I-2651, para. 19; Joined Cases C-397/98 and C-410/98, *Metallgesellschaft*, 2001 ECR I-1727, para. 37; Case C-319/02, *Manninen*, 2004 ECR I-7477, para. 19; Case C-446/03, *Marks & Spencer*, 2005 ECR I-10837, para. 29.

²³ Case 270/83, *avoir fiscal*, 1986 ECR 273, para. 26.

²⁴ Case 2/74, *Reyners*, 1974 ECR 631, para. 21; Case C-196/04, *Cadbury Schweppes*, 2006 ECR I-7995, para. 53.

²⁵ Case C-55/94 *Gebhard* [1995] ECR I-4165, para. 25, Case C-196/04, *supra* note 24, at para. 53.

²⁶ Case C-411/03, *SEVIC Systems*, para. 18.

²⁷ Case C-196/04, *supra* note 24, at para. 54, citing Case C-221/89, *Factortame*, 1991 ECR I-3905, para. 20 and Case C-246/89, *Commission v. United Kingdom*, 1991 ECR I-4585, para. 21.

²⁸ Case C-196/04, *supra* note 24, at para. 54.

that cases of *abusive practices* take place where operators improperly exercise the right of establishment, using it for a different objective.

II. The Concept of Abusive Practices as a Possible Justification for Restrictions of the Freedom of Establishment

Just like the objective of the freedom of establishment, the concept of *abusive practices* is a unitary one, applying to both individuals and companies. – Its presence can be the only justification of national measures restricting freedom for anti-avoidance reasons –. The ECJ case law is developing the concept of *abuse of rights* – or *abusive practices* in the spectrum of EU law and in relation to all fundamental freedoms in cases involving natural and legal persons. The concept has attracted intense scholarly debate all over Europe.²⁹ With specific regard to the exercise of the freedom of establishment and the area of direct taxation, the 2006 *Cadbury Schweppes* ruling can be regarded as the most significant, as the ECJ not only defined the abusive practices, by reaffirming a definition already provided in several previous rulings, but also indicated how the existence of an abusive practice could be detected.³⁰

In that case, a UK company had set up a subsidiary in Ireland for the purpose of having the subsidiary's profits taxed at the Irish corporate tax rate, which was substantially lower than the applicable UK corporate tax rate. Whilst the UK tax authority, according to UK law, had applied its national Controlled Foreign Companies (CFC) legislation (by attributing to the UK parent company the profits accrued to the Irish subsidiary), the ECJ, in assessing the incompatibility of UK CFC tax legislation with EU law – stated again that arts. 49 and 54

²⁹ Among the numerous contributions: Louis Neville Brown, *Is there a general principle of abuse of rights in European Community Law?*, in INSTITUTIONAL DYNAMICS OF EUROPEAN INTEGRATION, Vol. II 511, 513-515 (Deirdre Curtin & Tom Heukels eds., 1994); Anders Kjllgren, *On the Border of Abuse-The Jurisprudence of the European Court of Justice on circumvention, fraud and other misuses of Community Law*, 11 EUROPEAN BUSINESS LAW REVIEW 179-194 (2000); Karsten Engsig.Sorensen, *Abuse of Rights in Community Law: A Principle of Substance or Merely Rhetoric*, 43 COMMON MARKET LAW REVIEW 423-459 (2006); Pierre Schammo, *Arbitrage and Abuse of Rights in EC Legal System*, 14 EUROPEAN LAW JOURNAL 3, 351-376 (2008); Rita de la Faria, *Prohibition of abuse of (Community) Law: The Creation of a new general principle of EC law through tax*, 45 COMMON MARKET LAW REVIEW 395-441 (2008).

³⁰ This ruling has also been attracting wide scholarly debate; inter alia: Jan Sedemund, *Cadbury/Schweppes: Britische Regelungen zur Hinzurechnungsbesteuerung nur im Falle rein künstlicher Gestaltungen europarechtskonform*, BETRIEBS-BERATER 2119-2120 (2006); Philip Baker, *Pending Cases Filed by UK Courts I: The Cadbury Schweppes Case, the CFC and Dividend GLO and the Vodafone 2 Case*, ECJ RECENT DEVELOPMENTS IN DIRECT TAXATION, 311-321 (Michael Lang, Joseph Schuch & Claus Staringer eds., 2006); Manfred Köplin & Jan Sedemund: *Das BMF-Schreiben vom 8. 1. 2007 -untauglich, die EG-Rechtswidrigkeit der deutschen Hinzurechnungsbesteuerung nach Cadbury Schweppes zu beseitigen!*, BETRIEBS-BERATER 244-248 (2007); Mauro Beghin, *La sentenza Cadbury Schweppes e il "malleabile" principio della libertà di stabilimento*, 50 RASSEGNA TRIBUTARIA 983-993 (2007); Grahame Turner, *The Legitimacy of CFC Legislation Within the Community*, 9 THE EC TAX JOURNAL 23-47 (2007).

of the Treaty,³¹ by granting the right of establishment, have the ultimate purpose of assisting economic and social interpenetration within the internal market and stressed that this purpose could not be achieved in the case of a “letter-box” or “front” subsidiary which does not carry out any economic activity in the host State.³² On these grounds, the ECJ reached the conclusion that the CFC legislation was incompatible with arts. 49 and 54 of the Treaty and could thus not be applied, unless that application serves only to prevent *wholly artificial arrangements intended to escape the national tax normally payable*.³³ In referring to wholly artificial arrangements, the ECJ reaffirmed the definition of abusive practices that it had already used in several previous tax law rulings,³⁴ but it also went farther by specifying that CFC legislation must not be applied where, on the basis of objective factors which the interested company must be allowed to demonstrate, and which must be ascertainable by third parties, it is proven that, *despite tax motives*, the subsidiary is actually established in the host State and carries out a *genuine* economic activity.³⁵ The objective factors which must be demonstrated relate, in particular, to the physical existence of the subsidiary in terms of premises, staff, and equipment.³⁶

In addition to indicating the evidence to be considered for distinguishing cases of genuine establishment from wholly artificial arrangements, the ECJ identified the constituent elements of wholly artificial arrangements and it did so by applying a twofold test that it had developed in the *Emsland-Starke*³⁷ ruling in the common agricultural policy field, and in the *Halifax* ruling³⁸ in the Value Added Tax (VAT) field. By “importing” into the direct taxation field the elements of abuse of rights that it had identified in those rulings, the ECJ stressed that, for a wholly artificial arrangement to exist

[T]here must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community

³¹ Which were numbered, respectively, Art. 43 and Art. 48 of the EC Treaty at the time of the ECJ ruling.

³² Case C-196/04, *supra* note 24, at para. 68.

³³ *Id.* at para. 75.

³⁴ *E.g.*, Case C-264/96, *supra* note 24 at, para. 26; Case C-324/00, *Lankhorst-Hohorst*, 2002 ECR I-11779, para. 37; Case C-9/02, *De Lasteyrie du Saillant*, 2004 ECR I-2409, para. 49; Case C-446/03, *Marks & Spencer*, 2005 ECR I-10837, para. 57.

³⁵ Case C-196/04, *supra* note 24, at para. 65-66.

³⁶ *Id.* at para. 67.

³⁷ Case C-110/99, *Emsland-Starke*, 2000, ECR I-11569, para. 52 and 53.

³⁸ Case C-255/02, *Halifax* [2006], para. 74 and 75.

law, the objective pursued by the freedom of establishment...(i.e., assisting economic and social interpenetration within the EU through a genuine economic activity in the host State)...has not been achieved.³⁹

Cadbury Schweppes thus showed the application of the same test (including the subjective and the objective elements) for identifying the abusive practices from one area of EU law to another, and clarified that, in the field of direct tax law, wholly artificial arrangements – such as the setting up in other Member States of subsidiaries not carrying on genuine economic activities – are synonymous of abuse. Consequently, from *Cadbury Schweppes* it is also possible to deduce that a “U-transaction” – such as the creation of a subsidiary by a national of Member State A in Member State B for tax savings reason, and the fact that the activity of the subsidiary is *mainly* directed towards Member State A – amounts to circumvention which is *not* “wholly artificial”, i.e., which is not abuse, if the subsidiary carries on some genuine activity in Member State B.

Nonetheless, the fact that, in *Cadbury Schweppes*, the ECJ considered in principle the case of “letter-box” and “front-subsiaries” as falling within the “wholly artificial arrangements” that Member States can combat – and thus, impliedly, within the concept of abuse – gives rise to the question of whether and how *Cadbury Schweppes* can be reconciled with the 1999 *Centros* ruling.⁴⁰ Notably, in *Centros*, Danish nationals had set up a private company in the UK and this company had opened a branch in Denmark, where all business activity was deemed to be carried out. Although the relevant Danish authority had refused to register the branch on the ground that the Danish founders of the UK company had circumvented provisions of Danish company law requiring a minimum share capital for the purpose of protecting creditors, the ECJ had rejected this position. The ECJ had essentially found that the refusal to register the branch would prevent the company established in the UK by the Danish nationals from exercising its freedom of establishment guaranteed by the Treaty,⁴¹ and that there was no proven prejudice to creditors, who were able to know, the ECJ highlighted, that the company was governed by the law of a Member State other than Denmark and were able to refer to certain rules of EU law protecting them.⁴²

Because in *Centros* the parent company in the UK had only the registered office there and was arguably the kind of “letter-box” or “front” company that, according to *Cadbury*

³⁹ Case C-196/04, *supra* note 24, at para. 64.

⁴⁰ Case C-212/97, *Centros*, 1999 ECR I-1459.

⁴¹ *Id.* at para. 21.

⁴² *Id.* at para. 36.

Schweppes, a subsidiary could not be, part of the literature has found it difficult to reconcile the two rulings and has thus seen a change in the ECJ case-law.⁴³ However, in the author’s view, it is possible to reconcile the two rulings by having regard to the consequences of the arrangements at stake in the concrete cases for third parties’ interests. This perspective shows the similarity of the concept of abuse in the company law field and in the tax law field, despite a different terminology: the choice of a more favorable company law legislation (“forum-shopping”), via a “U-transaction”, is not on its own sufficient to prove abuse without a proven prejudice to the protection of specific third parties’ interests (such as creditors, in *Centros*) to the same extent as the choice to exercise the freedom of establishment in a Member State with a more favorable tax legislation than the Member State of origin is not sufficient to prove abuse (i.e., to prove a “wholly artificial arrangement”). However it can become so if the absence of a genuine economic activity in the host Member State shows that the *only* objective (and outcome) consists of a prejudice to the financial interest of the Member State of origin (*Cadbury Schweppes*). In addition, the two rulings could not be seen as inconsistent with each other considering that, in *Centros*, the secondary establishment in Denmark used to carry on a genuine economic activity, and would have thus met the requirement of not being a “letter-box” or “front-subsiary” branch as set out by the ECJ in *Cadbury Schweppes* to identify the cases when the use of the freedom to set up secondary establishments is protected by the Treaty due to its not being an *abusive practice*.

The concept of abuse as a wholly artificial arrangement resulting in a prejudice to the financial interest of a Member State was confirmed, and specified in greater detail, in the *Lammers*⁴⁴ ruling. Belgian tax authority, by applying a national anti-abuse provision, reclassified interest paid by a Belgian subsidiary on funds lent by the parent company established in another Member State as taxable dividends since interest payments exceeded limits. The Belgian tax legislation thus introduced a difference in treatment between resident subsidiaries according to whether or not their parent companies are seated in Belgium. The ECJ – consistent with its previous case-law – regarded this differential treatment as creating a restriction on the freedom of establishment on the ground that it made it less attractive for companies based in other Member States to create a subsidiary in Belgium. Although a national measure creating this restriction to the freedom of establishment could be justified, the ECJ explained, when targeting *wholly artificial arrangements* designed to circumvent national legislation of the Member States concerned,

[I]n order for a restriction on the freedom of establishment to be justified on the ground of

⁴³ Rita de la Feria, *Prohibition of abuse of (Community) law: the creation of a new general principle of EC Law through tax*, 45 COMMON MARKET LAW REVIEW 395, 428-429 (2008).

⁴⁴ Case C-105/07, *Lammer&Van Cleeffs*, 2008 ECR I-173.

prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, *with a view to escaping the tax normally due on the profits* generated by activities carried out on national territory.⁴⁵

This statement, on the one hand, confirms that in the ECJ tax caselaw *abusive practices* coincide with *wholly artificial arrangements*. On the other hand, it makes even more explicit than in *Cadbury Schweppes* that prejudicing the financial interests of Member States, without a corresponding economic activity, makes an arrangement abusive. Consequently, in the author's view, it is possible to reconcile *Centros* with *Cadbury Schweppes* and *Lammers*, by noting that the ECJ has expressed the distinction between mere circumvention and abuse with a different approach. In *Centros*,⁴⁶ it has done so with "positive" language, by essentially indicating *when* a circumvention *is allowed* and by specifying that it is allowed *when* it does not cause a prejudice to third parties' protection. In *Cadbury Schweppes* and *Lammers*, it has done so with "negative" language by indicating, ultimately, when a circumvention – "wholly artificial arrangement" – *is not allowed*, and by clarifying that it is not allowed when it *only* causes *a prejudice* to the financial interests (tax revenues) of the Member State of origin, which is the case in the absence of a genuine economic activity in the host State. Moreover, in the recent *Foggia* ruling⁴⁷ concerning the application of the anti-abuse clause of the Merger Directive,⁴⁸ the ECJ reaffirmed, as it had previously done,⁴⁹ that this anti-abuse clause "reflects the general principle of EU law that abuse of rights is prohibited" and cited as relevant previous rulings concerning this principle rulings issued in different areas, namely the *Halifax* ruling⁵⁰ in the VAT area, the company law *Centros* ruling⁵¹ concerning the exercise of the freedom of establishment, and the previous *Kofoed* ruling⁵² regarding the anti-abuse clause of the Merger Directive itself. Taking into consideration that intra-EU mergers have been regarded by the ECJ as one of the methods for companies to exercise their freedom of establishment, the *Foggia*

⁴⁵ *Id.* at para. 28.

⁴⁶ Case C-212/97, *supra* note 40.

⁴⁷ Case C-126/10, *Foggia*, 2011.

⁴⁸ Art. 11(a) of Directive 90/434/EEC of 23 July 1990, subsequently replaced by Directive 2009/133/EC of 19 October 2009.

⁴⁹ Case C-321/05, *supra* note 8, at 38.

⁵⁰ Case C-255/02, *supra* note 38.

⁵¹ Case C-212/97, *supra* note 40.

⁵² Case C-321/05, *supra* note 8.

ruling offers further inputs on how to detect “wholly artificial arrangements” in those particular situations where *both* tax-savings objectives and non-tax objectives are indicated by the economic operators.

In this ruling the ECJ went so far as to specify the concept of “valid commercial reasons” and the relation between other objectives and tax-savings objectives which should exist when both kinds of objectives are pursued in order for a merger not to fall within the anti-abuse clause of the Merger Directive. A Portuguese holding company had acquired three other companies who had incurred unutilized losses for a number of years, and had requested the tax authorities to allow these losses to be set off against its own taxable profits. The tax authorities refused to allow the deduction of losses of one of the acquired company who had carried out no activities, had generated no profit, had invested only in securities, and had incurred tax losses amounting to approximately €2 million. The acquiring company argued that the merger and resulting restructuring generated benefits in terms of savings in administrative and management costs, and that these other reasons constituted valid commercial reasons.

The ECJ, after recalling its previous case law under which in order for there to be valid commercial reasons a merger must be motivated by more than purely tax advantages, reaffirmed that, if several objectives are involved, tax considerations should not dominate. The ECJ accepted that, despite the fact that the acquired company did not carry out activities and the intention of the acquiring company to take over the losses, it could still be possible for the merger to be carried out for valid commercial reasons, and also stated that restructurings and rationalizations undertaken for cost-saving purposes can involve valid commercial reasons under the Merger Directive. Nevertheless, it stressed that, when deciding whether an operation falls under this category, *the level of the resulting tax advantages* should be taken into account. The ECJ concluded that the group’s cost savings were *marginal when compared to the level of tax benefits*, and therefore that the cost savings did not constitute a valid commercial reason.⁵³ Eventually, in light of this finding, the ECJ ruled that it is up to the national court to decide whether the transfer of tax losses as a result of the merger has valid underlying commercial reasons.

Overall, the concept of abusive practices – and the concrete modalities for identifying wholly artificial arrangements – appear well defined by the ECJ case-law, both in situations where non-tax objectives do not emerge and in situations where tax objectives co-exist with non-tax objectives. An abusive practice only exists where *either* tax savings objectives and outcomes are the *only* ones *or* – if they are pursued together with other objectives – if they are the *predominant* ones, which may involve a quantitative assessment as in *Foggia*. In either case, the objective of the freedom of establishment is not pursued by economic

⁵³ Case C-126/10, *Foggia*, 2011, para. 47.

agents, and their possibility of exercising this freedom can be restricted by national provisions having anti-avoidance purposes.

This gives rise to the question as to whether national provisions of Member States on tax residence of companies and individuals – in addition to indicating the fundamental nexus for direct taxation – can also be regarded as falling within the category of provisions having a general anti-avoidance purpose, due to their being aimed at securing tax revenues. In the author's view, the response should be positive because the protection of fiscal revenue is also, by definition, the key purpose of specific anti-avoidance measures, which target particular taxpayer's behavior aimed at reducing the tax burden.

This holds true, to an even greater extent, in light of the historical origin of the “place of effective management” connecting factor for allocating the tax residence, currently adopted by the OECD Model, from the “central management and control test” first developed in the UK for undeclared anti-avoidance reasons.

If accepting that the provisions on tax residence of Member States, when attracting back the tax residence of out moving taxpayers to the State of origin, can be equated to generic anti-avoidance provisions, these provisions would need to be consistent with the objective of the freedom of establishment and prevent only abusive practices.

C. The Exercise of the Right of Establishment by Companies and the “Place of Effective Management” as a Criteria for Allocating Tax Residence

I. The Application of a Domestic Version of the “Place of Effective Management” and its Defence vis-à-vis Clarification Requests by the European Commission: a Case Study

The application, by a Member State, of national provisions on corporate tax residence which intend to “attract” back to the country of departure the tax residence of taxpayers moving to other EU countries came under scrutiny of the European Commission in 2010. This occurred when the Commission requested clarifications from Italy about certain provisions of its direct tax code (TUIR) which consider, as Italian tax residents, certain companies created abroad, and thus set up in other EU Member States. The case, though concerning an individual Member State, appears to be of general interest because the arguments that the Italian tax authority⁵⁴ (AE) submitted in its response to the European Commission essentially demonstrated its freedom in establishing the connecting factors for tax residence and in applying these factors in the way that it considers most appropriate to protect its tax revenues, and would thus be likely to be shared by the tax authority of any other Member State which would be driven by the same concern.

⁵⁴ “Agenzia delle Entrate” [hereinafter “AE”].

Specifically, certain Italian tax provisions⁵⁵ establish a rebuttable presumption that a company, even if created abroad, is a tax resident in Italy when the majority of its members or directors are resident in Italy or when it is controlled by Italian resident companies. This presumption, named *foreign-dressing*, is intended to allow an effective application of one of the connecting factors laid down by the TUIR for establishing a company's tax residence, the “central administration” factor, according to which a company is tax resident in Italy if its decision-making centre is located in the Italian territory. When a company, even if created in any other Member State, has the majority of its members or directors in Italy or when it is controlled by Italian resident companies, the “foreign-dressing” presumption works by assuming that the company's decision-making centre is located in Italy and thus the company is an Italian tax resident due to the “central administration” factor.⁵⁶

It can be noted that situations which, under Italian provisions, would fall under the presumption of *foreign-dressing* specifically, where the majority of directors of the company registered in another country are residing in Italy, mirror the situation which, at the start of the 20th century, had been examined by the UK's House of Lords in the landmark *De Beers* case.⁵⁷ This marked a major step in the development of the “central management and control” criteria. In that situation, the majority of directors were resident in the UK despite the fact that the company was registered in South Africa and carried on business there. The House of Lords regarded the company as resident in the UK, by assuming that the decision-making centre was located there, just like the Italian provisions which came under scrutiny of the European Commission do in the event that the majority of directors is resident in Italy. The “central administration” connecting factor, due to its focusing on the company's decision-making centre, can be regarded as the domestic equivalent of the “place of effective management” criteria used by art. 4 of double tax conventions based on the OECD Model.

Before the request of clarifications by the European Commission, Italian tax courts examined the application of the *foreign-dressing* presumption in situations where the foreign company controlled by Italian residents was a holding company having interests in Italian companies, and had usually distinguished holding companies without an organizational structure in the country of incorporation from holdings which had some degree of presence in the EU Member State where they were set up and a degree of day-to-day managerial autonomy there. For example, a German holding company which, on

⁵⁵ Art. 73, par. 5-bis, ter and quarter of the TUIR.

⁵⁶ A similar presumption is also applied under Spanish tax law, which considers companies created in other countries as tax residents if most of their economic interests are located in Spain.

⁵⁷ *De Beers Consolidated Mines, Limited v. Howe* [1905] 2 K.B. 612.

the basis of documentary evidence presented by the A.E, was formed by its sole Italian shareholder only to escape Italian tax provisions by benefiting from more favorable German tax provisions and whose decision-making centre was in Italy, was regarded as “foreign-dressed” and thus as tax resident in Italy.⁵⁸ The German company held shares in Italian companies, was managed by the same Italian tax residents who were also directors of its parent holding company, had no financial autonomy, was fully subject to the direction of members living in Italy, and had neither a seat nor employees in Germany. On the contrary, a Dutch holding company which, despite being subject to instructions issued by the Italian parent company, did not own in Italy any real estate, bank accounts, representative offices, or other links, but had an office in Amsterdam, employed a Dutch national who was also an expert in administration and audit, paid compensation to local auditors and resorted to legal, tax and accounting consulting services provided by a Dutch consulting firm, was found not to be resident in Italy.⁵⁹ In that case the court attached importance to the existence of an autonomous organizational structure in the Netherlands and regarded the relation between the Italian parent company and the Dutch holding company as falling within the normal relationship of control, leaving enough autonomy to the day-to-day financial holding services activity of the company, although keeping it under the normal supervision of the parent company. In this case, whilst regarding the Dutch holding as not residing in Italy, the court also stated that the “central administration” criterion for identifying the tax residence is always applicable when the residence in the foreign country is *only motivated by tax evasion or tax avoidance reasons*,⁶⁰ which it found not to be the case in the specific situation. Therefore, in applying through the presumption of “foreign-dressing” a connecting factor for tax residence (the “central administration”) representing its domestic translation of the “place of effective management criteria”, the Italian tax case-law, which preceded the European Commission's request for clarification, expressly stated that it recognizes that this connecting factor fulfils an anti-avoidance role – the same purpose that the UK's House of Lords seems to have been pursuing, without openly indicating as much, in its earlier case-law.

In 2010 the European Commission questioned the compatibility of the Italian provisions setting the presumption of *foreign-dressing* with the freedom of establishment and with the free movement of capital⁶¹ in light of the ECJ caselaw and, in particular, of the *Barbier*⁶²

⁵⁸ Provincial Tax Court of Belluno, 3 December 2007 – 14 January 2008, rulings 173/01/2007 and 174/01/2007.

⁵⁹ Regional Tax Court of Tuscany, sez. XXV, 3 December 2007 – 18 January 2008, n. 61/25/27.

⁶⁰ *Id.* at para. 4.

⁶¹ Case 777/10/TAXU.

⁶² Case C-364/01 *Barbier*, 2003 ECR I-15013.

and *Cadbury Schweppes*⁶³ rulings. However, it *did not go as far as to call into question the compatibility of the “place of effective management” criterion with the exercise of freedom of establishment by companies*. This arguably facilitated the responses by the AE. In its responses,⁶⁴ the AE considered the ECJ's judgments in *Barbier* and *Cadbury Schweppes* as irrelevant to the issue under consideration, and it argued that the constituent elements of the concept of tax residence, and in particular the connecting factor given by the “central administration”, are *distinct* from the exercise of a genuine economic activity in another Member State. The AE further added that the “central administration” criteria is consistent with the solutions adopted by other jurisdictions and with the criterion of “place of effective management” incorporated in the OECD Model and in bilateral tax conventions based on this Model, and stressed the possibilities left to the concerned companies to rebut the presumption by demonstrating that their decision-making centre is not located in Italy. In so doing, the Italian tax authority expressly stated that the evidence to be used to prove the location of the central administration abroad in order for a taxpayer to rebut the presumption of *foreign-dressing* is the same as could serve to prove the existence of the “effective place of management” for the purpose of double tax conventions.

Irrespective of the particular Italian provisions at stake in the concrete case, these arguments submitted by the AE appear of general interest from the viewpoint of other Member States too because in defending the “central administration” criteria the Italian tax authority ultimately ended up defending the “place of effective management” criteria which is usually employed by Member States in their bilateral double tax conventions.

The European Commission, based on the clarification about the burden of proof provided by the AE, decided not to pursue the case further.⁶⁵ It essentially came to this conclusion on the grounds that a Member State is entitled to decide the connecting factors to determine the tax residence in its jurisdiction, and that a restriction to fundamental freedoms could be found, in its view, only if it were impossible for a taxpayer to rebut the presumption of existence of a connecting factor. The European Commission was thus satisfied that – from the information it received – there are no proofs indicating that a taxpayer would be unable to rebut the presumption.

Although the AE's arguments convinced the European Commission, there appear to be other aspects which have not been dealt with by the European Commission itself in its requests for clarifications, but may still give rise to doubts as to whether a presumption intended to apply the “central administration” connecting factor, and the “place of effective management criteria” in itself, are compatible with the freedom of establishment

⁶³ Case C-196/04, *supra* note 24, retro, par. B, II.

⁶⁴ Ref. 3-1923/2010.

⁶⁵ European Commission's letters to Italy on 4 June 2010 and 11 January 2011.

and its economic integration objective. Indeed, shortly after the introduction of the *foreign-dressing* presumption, part of the Italian literature argued that this was incompatible with the freedom of establishment, on the ground that, in addition to dissuading the creation of companies in other Member States, the provisions establishing this presumption do not set any limit to their scope and apply to all other EU Member States, irrespective of their tax regimes.⁶⁶

II. The tax residence definition and the exercise of companies' freedom of establishment as independent from each other?

It is important that, as discussed in part B, the place of effective management" as a tiebreaker rule for corporate tax residence allocation can be at odds with the exercise by companies of the freedom of establishment. This can occur in a situation in which, for example, a company moves its registered office alone to another Member State by converting its legal form as allowed by the *Cartesio* ruling, and carries out in this State a genuine business activity in terms of production and commercialization integrating it into the local economy. This form of outbound transfer would be *protected* by the provisions on companies' freedom of establishment because it would be consistent with their economic integration objective. Nevertheless, it would not be recognized by the AE's position, which would regard the company as *foreign-dressed* and would also be irrelevant under the "place of effective management" criteria, which would leave the tax residence unaffected. In fact, in its responses to the European Commission, the Italian tax authority identified the genuine nature of the establishment in another State exclusively with the location in that other State of the place of decision-making, without mentioning the cases of possible dissociation between this place and the place where the production and commercialization activity is carried on. Nevertheless, the importance of the location of the company's productive activity clearly emerges from the *Cadbury Schweppes* ruling, which, as previously noted, made it clear that national anti-avoidance provisions are incompatible with the freedom of establishment when the creation of a subsidiary in another Member State leads to a genuine economic activity in this second State and thus cannot be regarded as a wholly artificial arrangement.

⁶⁶ See P. Bertolaso & E. Bressan, *Le "esterovestizioni" alla prova della presunzione di residenza – Alcune considerazioni con particolare riguardo alle holding statiche*, 36 IL FISCO, 5617, (2006); L. Del Federico, *Società estere e presunzione di residenza ai sensi del D.L. 223/2006: articoli 43 e 48 del Trattato CE, Convenzioni contro la doppia imposizione e disapplicazione della norma interna di cui al comma 5-bis dell'Art. 73 del Tuir*, 41 IL FISCO (2006); Marco Greggi, *Recenti sviluppi e questioni di compatibilità comunitaria delle disposizioni di contrasto al fenomeno della cosiddetta "esterovestizione" societaria*, LII1 RASSEGNA TRIBUTARIA 105-134 (2009).

Although the ECJ has not provided, in this ruling, a definition of “place of effective management” other than the OECD definition,⁶⁷ the literature has been reading the *Cadbury Schweppes* ruling as implying a significant nexus between the “effective management” in a particular place and conduct, in that place, of a genuine economic activity.⁶⁸ More specifically, some authors interpret the ruling as meaning that the ECJ identifies the tax residence of a company (for direct taxation purposes) with the place where its economic activity is concretely carried on. This place would be in the Member State where the company can demonstrate both an economic integration (effective exercise of a genuine activity) and a temporal integration (participation in the economic life on a stable and continuing bases),⁶⁹ which, ultimately, would make the tax residence coincide with the place where the company's profit is produced.⁷⁰ Undoubtedly, the local production of wealth, as a result of socio-economic integration, allows a natural person or a company to participate on a stable and continuous basis in the economic life of a Member State other than that of origin, and to benefit therefrom, thereby achieving the goal of the freedom of establishment which, as repeatedly indicated by the ECJ, consists of integration in the host State.

On the other hand, *Cadbury Schweppes*, while not providing—as pointed out by the A.E.—a definition of tax residence different from the criterion indicated by the OECD Model, led to the same result which would have derived in the concrete situation from a refusal to recognize the tax residence of the Irish company in the UK, *i.e.* it led to the impossibility of taxing the profits of the Irish company in the UK in the presence of an effective economic integration of the subsidiary in Ireland.

Consequently, the position taken by the Italian tax authority in defending the “place of effective management” connecting factor—although they would probably be shared by the tax authorities of any other Member States both on the basis of the OECD Model, and also because it would allow them to shed from potential scrutiny its connecting factor for tax residence—still seems to leave doubts as regards its consistency with the economic integration objective of the freedom of establishment and with the related freedom to choose the form of establishment.

Admittedly, the argument whereby the constituent elements of the tax residence concept are distinct from the exercise of a genuine economic activity in another Member State

⁶⁷ “[T]he place where the most senior person or group of persons (for example, a Board of Directors) makes its decision”: OECD COMMENTARY ON ART. 4, para. 24

⁶⁸ Pierpaolo Valente, *la Residenza Fiscale nel Diritto Tributario Internazionale e Comunitario*, 2 NEOTEP 11, 20 (2009).

⁶⁹ Moschetti, *supra* note 2; BEN J.M. TERRA & PETER J. WATTEL, *EUROPEAN TAX LAW* (2008), at 42.

⁷⁰ Moschetti, *supra* note 2, at 38.

might be supported, on a first reading, by legislation and ECJ caselaw in the area of VAT. With respect to legislation, it is sufficient to note that Regulation 282/2011⁷¹ states “the place where the business of a taxable person is established shall be the place where the functions of the business's central administration are carried out” and that, in order to determine that place,

[A]ccount shall be taken of the place where essential decisions concerning the general management of the business are taken, the place where the registered office of the business is located and the place where management meets. Where these criteria do not allow the place of establishment of a business to be determined with certainty, the place where essential decisions concerning the general management of the business are taken shall take precedence.⁷²

As regards ECJ's rulings in this area, in the 2007 *Planzer Luxembourg* ruling the ECJ stated that “the place of a company's business is the place where the essential decisions concerning its general management are taken and where the functions of the central administration are exercised”⁷³ and concluded that “a fictitious presence, such as that of a 'letter-box' or 'brass-plate' company, cannot be described as a place of business”⁷⁴ for the purpose of the Thirteen VAT Directive, which was at stake. These *Planzer Luxembourg* findings have more recently been reaffirmed in the 2011 *Stoppelkamp* ruling.⁷⁵

Nonetheless, despite the definition provided by Regulation 282/2011, and the circumstance that the ECJ, in *Planzer Luxembourg*, referred to, *inter alia*, in *Cadbury Schweppes* as a precedent in another area, a further aspect comes into play. Specifically, even if one were to draw the notion of company's residence from VAT-related legislation and case-law, the purpose of the VAT legislation is different from the purpose of direct taxation, which has a different underlying philosophy.⁷⁶ Thus, this notion of residence would not seem to be helpful in the field of direct taxation, which unlike VAT remains

⁷¹ Regulation 282/2011/EU of 15 March 2011, laying down implementing measures for Directive 2006/112/EC on the common system of VAT

⁷² *Id.* at Art. 3

⁷³ *Id.* at para. 60-61.

⁷⁴ *Id.* at para. 62

⁷⁵ Case C-421/10, *Stoppelkamp*, 2011.

⁷⁶ Joachim Englisch, *VAT/GST and Direct Taxes: Different Purposes*, in *VALUE ADDED TAX AND DIRECT TAXATION SIMILARITIES AND DIFFERENCES*, 2 (Michael Lang, Peter Melz, Eleonore Kristoffersson eds., 2009).

under national tax competence, and with regard to the exercise of the freedom of establishment, the latter alone being involved in the direct taxation area in *Cadbury Schweppes*. Moreover, to assume that the definition of residence emerging from the VAT legislation would also apply in the area of direct taxation would certainly be appropriate for the revenue interest of the State of location of the place of effective management. But the ECJ has stated in several rulings that the need to prevent reduction in tax revenues is not, in itself, a matter of overriding general interest justifying a restriction on a freedom granted by the Treaty.⁷⁷

Two further arguments –on a first reading– might be put forward to assert that the “place of effective management” criteria laid down by bilateral tax conventions based on the OECD Model would be “adopted” under EU law and thus that this criteria would, by definition, never conflict with the freedom of establishment. First, in a number of direct taxation rulings concerning the fundamental freedoms, the ECJ has consistently stated that, at the current stage of EU law, Member States are free to allocate between themselves the taxing powers according to double tax conventions based on the OECD Model,⁷⁸ i.e. exactly according to those double tax conventions that usually indicate the “place of effective management” as a criteria for allocating tax residence. Second, the few EU Directives in the field of direct taxation concerning companies (such as the Parent-Subsidiary Directive, the Merger Directive, the Interest-royalties Directive) refer to “any companies which...according to tax laws of a Member State, is considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third country, is not considered to be resident for tax purposes outside the Community”.⁷⁹

Nevertheless, these arguments can meet three objections which suggest that *neither* the ECJ's acceptance of the distribution of taxing powers according to double tax conventions *nor* the EU Directives' reference to the national laws of Member States can be taken as implying that the place of effective management as a connecting factor could be regarded as *always* compatible with the freedom of establishment.

A first objection is suggested by the ECJ's own wording in those cases where its rulings recognized Member States' freedom to follow the OECD Model in entering into bilateral conventions for eliminating double taxation. In fact, the ECJ reached that position by stating “in the absence of any unifying or harmonizing Community measures...it is not

⁷⁷ See e.g., Case C-196/04, *supra* note 24, at para. 49 and the case-law cited there.

⁷⁸ See e.g., Case C-336/96, *Gilly*, 1998 ECR I-02793, para. 31; Case C-307/97, *Saint-Gobain ZN*, 1999 ECR I-6161, para. 57; Case C-513/03, *van Hilten*, 2006 ECR I-1957, para. 47.

⁷⁹ Council Directive 90/435/EEC (Parent-Subsidiary Directive), Art. 2; Council Directive 2009/133/EC (Merger Directive), Art. 3; Council Directive 2003/49/EC (interest-royalties Directive), Art. 3.

unreasonable” for the Member States to base their bilateral conventions on the OECD Model.⁸⁰ Arguably, stating that following the OECD Model is *not unreasonable* does not necessarily mean that this choice (implying the related connecting factor for tax residence) is the *best possible* option, but it only means that it is a possible *default option* in the absence of a more suitable alternative. This implied meaning is evident in the ECJ's statement whereby Member States have this freedom *in the absence of any unifying or harmonising* EU measure.

Second, it could be noted that, in certain cases when the distribution of taxing powers according to double tax conventions resulted in discriminations in the host State against taxpayers exercising a fundamental freedom, the ECJ went as far as establishing which State should take into account the taxpayer's overall ability-to-pay, and thus which State should take *de facto* the role of residence State. And it did so irrespective of which State was regarded as the residence State under double tax conventions; although the ECJ did so in the *Schumacker* line of case-law concerning natural persons,⁸¹ the ECJ's approach was regarded by the literature⁸² as applying *mutatis mutandis* to companies too. Interestingly, in the *Schumacker* ruling, the ECJ, by recognizing that the residence State is normally the one in which the financial interests of the taxpayer are centered,⁸³ implicitly accepted this normal circumstance as underlying justification for Member States' freedom to conform bilateral treaties to the OECD Model as regards the connecting factor for tax residence too. In consequence, it could be inferred, *a contrario*, that it would be difficult for a Member State of location of the “place of effective management” of a company which, by assumption, has its registered office and its business activity in another Member State, to justify the claim of tax residence on the basis of the place of effective management alone when the financial interests of the company are concentrated in another Member State. In this situation, it would be the latter State which, arguably on the basis of the justification based on the concentration of financial interests, would need to be able to claim the tax residence.

Thirdly, it could well be argued that, because of the lack of a uniform connecting factor for tax residence within the EU, the tax Directives, which are aimed at eliminating double taxation for specific operations between companies of different Member States, *necessarily* had to refer to national (and double tax conventions) definitions of tax residence. In other words, the circumstance that the ECJ accepted Member States'

⁸⁰ Case C-336/96, *supra* note 79, at para. 30-31; Case C-513/03, *van Hilten*, 2006 ECR I-1957, para. 47-48; Case C-470/04, *N*, 2006 ECR I-7409, para. 44- 45.

⁸¹ See e.g., Case C-279/03, *Schumacker* [1995] ECR I-225

⁸² Jan Wouters, *Fiscal Barriers to Companies' Cross-Border Establishment in the Case-Law of the EC Court of Justice*, 14 YEARBOOK OF EUROPEAN LAW 73 (1995).

⁸³ *Schumacker*, *supra* note 82, at paras. 32-33

freedom to distribute taxing rights and that EU Directives refer to national tax laws and double tax conventions cannot indicate that any connecting factor is by definition adopted under EU law *irrespective* of its potential effect on the exercise of fundamental freedom. On the contrary, this circumstance can only mean that, at the current stage of development of EU tax law, Member States are still free to determine the connecting factors, and, in particular, it indicates that the issue of whether the application of a specific connecting factor for tax residence may run contrary to the objective of a fundamental freedom has not yet been raised.

Accordingly, although the individual Member States are free to choose the connecting factors for corporate tax residence and to apply such factors as they deem it appropriate, the application of these connecting factors cannot be regarded as exempt from scrutiny under EU law. On the contrary, to the extent that this choice (also) serves a general anti-avoidance purpose it appears inevitable that (the application of the) connecting factor at stake should be able, just like other anti-avoidance provisions, such as CFC under scrutiny in *Cadbury Schweppes*, to stand the test of preventing *solely* wholly artificial arrangements, which, as specified by the ECJ, cannot be assumed to exist in the event of a genuine integration in the host State.

III. Different Assessment for Different Situations and (Further) Arguments for a Rethinking of the Connecting Factor

This position seemed to be impliedly accepted by the European Commission itself in its 2007 Communication on the application of anti-abuse measures in the area of direct taxation,⁸⁴ which expressly stated, by analyzing the ECJ's case-law, that “the objective of minimizing one's tax burden is in itself a valid commercial consideration as long as the arrangements entered into with a view to achieving it do not amount to artificial transfers of profits,”⁸⁵ i.e. as long as a genuine business activity is carried on in the host country. Specifically, the European Commission stated

In order for anti-abuse rules to be justified, they must be confined to situations in which there is a further element of abuse. In its recent case law the ECJ has given more explicit guidance on the criteria for detecting abusive practices, i.e. wholly artificial arrangements. In *Cadbury*, the ECJ held that an establishment is to be regarded as genuine where, based on an evaluation of objective factors which are ascertainable by third parties, in particular evidence of physical existence in terms of premises, staff and equipment, it reflects economic reality, i.e. an actual

⁸⁴ Communication COM (785) 2007 final.

⁸⁵ *Id.* at 3.

establishment carrying on genuine economic activities and not a mere "letterbox" or "front" subsidiary".⁸⁶

On the other hand, the European Commission recognized, in the same Communication, that "it is not altogether certain how those criteria may apply in respect of, for example, intra-group financial services and holding companies, whose activities generally do not require significant physical presence"⁸⁷ in the host Member State.

In the author's view, this distinction between different situations—used by the European Commission and, as noted above, by the Italian tax caselaw—is the key for identifying the cases when the application of the "place of effective management" criteria by the Member State of "emigration" can be consistent with the freedom of establishment of companies and other cases when it cannot.

In light of the elements referred to by the ECJ in *Cadbury Schweppes*,⁸⁸ whose presence or absence can exclude or indicate the objective aspect of an "abusive practice", it can be argued that, in situations of *mere holding companies* set up in another Member State without an organizational structure, an anti-avoidance provision like the Italian "foreign-dressing" presumption and the underlying connecting factor given by the central administration/place of effective management is entirely consistent with the ECJ case-law. This is because, in those situations, the purpose of the freedom of establishment is not achieved due to the *lack of any integration* in the other EU Member State at stake. In other words, in the situations at stake the kind of connection with the territory of another EU country which is, according to the ECJ case law, necessary and sufficient to achieve the objective of the freedom of establishment –i.e. the exercise of a genuine business activity on a stable and continuous base leading to economic integration in that country⁸⁹—does not exist. In this kind of situation, the connecting factor for tax residence lying in the place where the managerial decisions are taken does not risk hindering the purpose of the freedom of establishment. According to the author, such realization is also consistent with the recognition by the European Commission, in its 2007 Communication,⁹⁰ that the criteria of exercise of a genuine economic activity might not apply "in respect of, for example...holding companies, whose activities generally do not require significant physical presence". The realization that the activity of holding companies does not require *significant* physical presence, and thus a significant organizational structure, does not

⁸⁶ *Id.* at 4.

⁸⁷ *Id.*

⁸⁸ See *Cadbury Schweppes*, *supra* note 24, at para. 67.

⁸⁹ *Id.*

⁹⁰ COM (785) 2007 final, at 4.

indicate that the activity can be carried out with *no* physical presence or with such a *minimal* presence as to lead to *no real* interaction with the local economy.

As noted by the literature, the ECJ's case law on abuse of rights in relation to the freedom of establishment limits the scope of the "foreign-dressing" presumption by indicating that only wholly artificial arrangements can be contrasted by national anti-avoidance measures.⁹¹ Consequently, it should also be regarded as limiting the application of the "central administration"/"place of effective management" connecting factor for tax residence to those companies set up in other Member States for avoidance purposes. This was impliedly recognized by the Italian case law when stating that the "central administration" criteria must always be applied when a company is set-up by Italian taxpayers in the foreign country and when the setting up of a company is *only motivated by tax evasion or tax avoidance reasons*.⁹² This position is fully consistent with the findings of the ECJ caselaw that limited the application of anti-avoidance measures to wholly artificial arrangements.

As a result, the application of this connecting factor would no longer be justified by EU caselaw if it were to hinder the creation of companies in other EU countries, or the transfer there of the registered office as allowed by the *Cartesio* ruling⁹³, for genuine business reasons. This conclusion would also apply if the creation of companies, in other EU countries, was justified by tax savings reasons, but results in the exercise of a genuine business activity and thus leads to a genuine economic integration in the host country.

The hypothesis of mere *holding* companies *either* without an organizational structure⁹⁴ *or* with a such a minimal structure as not to integrate their activity into the economy of another Member State, would therefore need to be distinguished from at least three other situations: (a) holding companies having an organizational structure which, even if not significant, show such a threshold as to demonstrate a sufficient level of integration in the economy of the host country that could be necessary to their carrying on a genuine service-activity there; (b) mixed holding companies carrying on both financial and manufacturing/commercial activities in the host country; and (c) companies carrying on purely manufacturing or commercial activities fully integrated in the foreign country of incorporation.

⁹¹ Marcello Poggioli, *Nuove logiche di pianificazione fiscale internazionale*, 4 NEOTERA 7 (2011).

⁹² See *supra*, in paragraph C. I, the Regional Tax Court of Tuscany ruling, cited *supra*, notes 59 and 60.

⁹³ I.e. with conversion of the legal form into a form offered by the State of destination: see *Cartesio*, *supra* note 19, at para. 111-112.

⁹⁴ See Provincial Tax Court of Belluno, *supra* note 58.

With regard to these other situations, in the author's view, even in those cases where the managerial decisions were taken in one country, but the company transferred its registered office, as allowed under the *Cartesio ruling*, to a second EU country and carried out a genuine activity in this other country, which leads to an effective integration there in terms of physical presence and relations with local economic operators resulting in commercial benefits, the application of the "place of effective management" as a connecting factor for tax residence (as accepted under the OECD Model of decision-making centre) by the first country would contrast with the goal of the freedom of establishment. This would occur because, in these situations, it would be impossible to find an *abusive practice* behind the setting up of the company due to the economic interpenetration in the other Member State at stake. This interpenetration would achieve the objective of the freedom of establishment, but would risk being discouraged⁹⁵ by the application of the "place of effective management" itself.

Consequently, it follows that, for proving the existence of situations where the "place of effective management" should no longer be applied in all cases of genuine economic integration in the host Member State, the evidence to be used by the taxpayer, under the *Cadbury Schweppes* ruling, to demonstrate an actual economic activity in the host country, should be necessary and sufficient. Moreover, from the *Foggia* ruling,⁹⁶ it could be argued *mutatis mutandis* that, when both tax savings reasons and business reasons were expressly indicated by the company concerned for its concentration of the business activity in the host Member State, the relevance of the elements indicated in *Cadbury Schweppes* could be strengthened through a quantitative assessment of the predominance of other economic benefits over tax benefits deriving from the location in the other EU country at stake.

As already noted,⁹⁷ the ECJ stated, in *Cadbury Schweppes*, that the assessment of the presence or absence of wholly artificial arrangements must be based on elements which are objective and ascertainable by third parties. These elements consist, in particular, of the physical presence of the foreign subsidiary in terms of premises, staff, and equipment and in the genuine exercise of the activities in the host country. The specification "*in particular*" indicates that, although these elements might not be unique, they must be regarded as the most important ones. The adequate presence of these elements, especially if further enhanced through a quantitative assessment of the non-tax benefits, allows the activity actually performed, according to the decision of the ECJ, to be considered as the primary purpose and outcome of the creation of the company in another

⁹⁵ As it was argued by the Italian literature with regard to the "foreign-dressing" presumption intended to apply the "central administration" criteria: see *supra*, in paragraph C, I., the literature cited in note 66.

⁹⁶ See *Foggia*, *supra* note 47, at para. 47.

⁹⁷ See the discussion *supra* in paragraph B, II, about the *Cadbury Schweppes* ruling.

Member State, which meets the economic integration objective of the freedom of establishment and makes it possible to assume that tax savings reasons—even when existing—only have a secondary role.

This would be so because, apart from the quantitative assessment in *Foggia* of the relevance of non-tax benefits as opposed to tax benefits, the ECJ did not indicate other specific factors to be proven for demonstrating the prevailing non-tax purpose, i.e. the economic integration objective. But in *Cadbury Schweppes*, the ECJ inferred it from the physical presence of the foreign subsidiary in terms of premises, staff, and equipment and in the genuine exercise of the activity in the host country.

It can be added that in a modern, computerized economy, where decisions by members of a company's board of directors could be taken by means of electronic communication, such as emails, videophone or videoconferencing between individuals living in different countries, locating the “place of effective management” as intended by the OECD Commentary (“place where the key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made”) in a particular country may become more and more difficult. This is because, as highlighted by the literature, “it is perfectly possible for a company to be genuinely managed and controlled from several countries simultaneously.”⁹⁸ The OECD itself showed awareness about the impact of global communication technology in its 2001 Discussion Draft⁹⁹ (followed by a 2003 Discussion Draft¹⁰⁰) suggesting changes to the place of effective management concept, which considered some tiebreaker tests that could be an alternative to the “place of effective management, and indicated, amongst the potential alternatives, “where the economic nexus is strongest”, i.e. the *place where the enterprise's economic links are strongest*

Although these suggestions have not yet resulted in the replacement by the OECD of the “place of effective management” with an alternative criteria, such as *the place where the enterprise's economic links are strongest*, it follows from the foregoing analysis that a connecting factor such as the latter—which could be identified in the place where the company carries on its activity in terms of production and/or commercialization and uses a physical presence for this purpose—would actually indicate the place where the company shows concrete integration into the local economy. In so doing, it would be fully

⁹⁸ See *supra* note 1, at 67.

⁹⁹ OECD (2001), THE IMPACT OF THE COMMUNICATION REVOLUTION ON THE APPLICATION OF 'PLACE OF EFFECTIVE MANAGEMENT' AS A TIEBREAKER RULE, A DISCUSSION PAPER FROM THE TECHNICAL ADVISORY GROUP ON MONITORING THE APPLICATION OF EXISTING TREATY NORMS FOR THE TAXATION OF BUSINESS PROFITS, at 11-12.

¹⁰⁰ OECD (2003) PLACE OF EFFECTIVE MANAGEMENT CONCEPT: SUGGESTIONS FOR CHANGES TO THE OECD MODEL TAX CONVENTION, DISCUSSION DRAFT 27 MAY 2003, at 5.

consistent with the purpose of the freedom of establishment, in addition to offering a tangible factor of connection with the territory of any given Member State. Furthermore, by making the tax residence of companies coincide with the place where their financial interests are concentrated, a tie-breaking connecting factor consisting of the place of the company's closest economic links, could be regarded as fully justified by the recognition by the ECJ itself, in the *Schumacker* ruling, that the residence State is normally the one where the financial interests of the taxpayer are centered,¹⁰¹ and by the ultimate purpose of any taxation system, i.e. to ensure that all natural or legal persons deriving income from a jurisdiction contribute to public expenditure within that State. In fact, the place of the company's closest economic ties, resulting in the place where the company has its main economic interests due to relations with suppliers, financiers and customers, would also be the place where most of the company's profit is generated and where the company benefits from local services in carrying out its overall activity. This perspective lends justification to the company's contribution to public spending in the country at stake through its taxation on worldwide income and therefore through the allocation of tax residence to the Member State under consideration.

Another reason for a rethinking of the connecting factor for a company's tax residence within the EU could be the possible introduction of a European Private Company (EPC), i.e. a form of private limited company governed by European law which, according to the Commission's proposal,¹⁰² would be available to (small and medium-sized) businesses from all Member States and could be created with the registered office in one State and the head office (place of effective management) in another State.¹⁰³ Because keeping the registered office and the head office in two different Member States – as well as concentrating its business activity in the Member State of location of the registered office if this were more convenient – would be one of the *natural* prerogatives of an EPC as part of its *normal* business operations, it could be argued that the Member State of location of the “place of effective management” would be unable to invoke *particular* reasons, such as *anti-abuse* reasons, for claiming the tax residence of the company. At the same time, the other Member State, due to the economic interest of the company being concentrated there, would be better placed to assess the taxpayer's overall ability to pay and thus to play the role of tax residence Member State.

Admittedly, from the viewpoint of the Member State of origin of a company whose registered office was transferred and whose business were entirely conducted in another

¹⁰¹ See *Schumacker*, *supra* note 82, at paras. 32-33.

¹⁰² Proposal for a Council Regulation on the Statute for a European Private Company, COM(2008)396/3.

¹⁰³ For an in-depth analysis of the Commission's Proposal for a EPC Statute, see Rolandino Guidotti, *The European Private Company: The Current Situation*, 13 GERM. L. J. 331 (2012).

Member State in terms of production and commercialization, continuing to apply a connecting factor giving importance to the decision-making centre would be, an effective means for protecting its revenues interests. Nevertheless, this would not be in itself a legitimate reason because the ECJ held on several occasions that the protection of revenues interest is not, in itself, an overriding public interest reason to justify a measure having a dissuasive effect on the exercise of the freedom of establishment.¹⁰⁴

To sum up, it can thus be argued that, despite being made increasingly obsolete in the era of electronic communications, the resort to the “place of effective management” connecting factor for tax residence by an EU Member State can still find a (residual) justification only in those cases of location of the registered office of a company in another Member State for tax avoidance purposes. Consequently, it can also be inferred that this connecting factor for corporate tax residence lends itself to criticism of inconsistency with the objective of the freedom of establishment in all instances where the presence of the elements indicated by the ECJ in *Cadbury Schweppes* deprives it of potential justifications on anti-avoidance grounds.

With regard to these latter cases, a rethinking of the connecting factor to be used as a tiebreaker rule for a company's tax residence allocation, such as selecting a new connecting factor based on the *place where the company has the closest economic ties* (one of the alternatives discussed in the OECD since 2001-2003), would certainly be appropriate, and this would apply to an even greater extent should the EPC be introduced.

D. Hypothesis for the Application of an Alternative Connecting Factor for Corporate Tax Residence

If an alternative connecting factor for corporate tax residence purposes –lying in the *place of the company's closest economic ties*– were to be introduced within the EU for application, as a tiebreaker rule, to cover all situations where companies have a head office in one Member State but are integrated into the economy of another Member State, it would be necessary to find a mechanism to ensure the smooth application of this connecting factor under conditions of legal certainty.

In this respect, it could be noted that some recent double tax treaties –such as the new double tax convention between the Netherlands and the UK¹⁰⁵– in Art. 4 no longer adopt the “place of effective management” criteria as a tiebreaker rule for tax residence. Rather,

¹⁰⁴ See *Cadbury Schweppes*, *supra* note 24 at para. 49, and the previous case-law cited in that note.

¹⁰⁵ UK-Netherlands Double Tax Convention, signed on 26 September 2008, available online at: <http://www.hmrc.gov.uk/taxtreaties/in-force/2008-netherlands-uk-dtc.pdf> (last accessed: 31 August 2012).

they establish that, in cases where both contracting States regard a company as their own resident under domestic law, the residence should be allocated by means of agreement between the Member States concerned. Similarly, double tax conventions that still use the place of effective management criteria as a tiebreaker rule do require an agreement between the concerned tax authorities over residence allocation in cases where it is impossible to identify the place of effective management. Such an agreement is reached through the mutual agreement procedure (MAP) set out by Arts. 25 of the OECD Model and of double tax conventions based on it.¹⁰⁶ Until the agreement is reached—which may take a number of years¹⁰⁷—the company is left with legal uncertainty. Moreover, in the event that no agreement is reached on the location of the “place of effective management” between two tax authorities both claiming that the company’s decision-making center is located in their territory, the company would risk facing worldwide taxation in two countries. This risk exists because the MAP generally requires the contracting States to make their *best efforts* to reach an agreement, but not to actually reach an agreement, *unless* the double tax convention at issue incorporates an arbitration clause in the context of the MAP, as was indeed recommended by the 2008 revision of Art. 25 of the OECD Model and by the European Commission in its 2011 Communication on double taxation.¹⁰⁸ Only a small number of double tax conventions actually contain such an arbitration clause,¹⁰⁹ thus implying that most companies would face legal uncertainty and risks of double taxation in the event of disagreement between two countries regarding the location of the place of effective management.

As noted above, an alternative connecting factor for corporate tax residence purposes based on the place of the closest economic ties. This could be verified through the application of objective criteria such as the physical presence in terms of premises, staff, equipment, and production activity. Using the place of economic ties as a connecting factor for corporate tax residence purposes would be well grounded from the viewpoint of the very rationale of a tax system, in addition to being easier to verify than the “place of effective management”.

If the place of the closest economic ties were assumed as a new connecting factor in double tax conventions between Member States, the provision of these double tax

¹⁰⁶ Miller, Oats, and Bus, *supra* note 1, at 143, highlight that establishing a single State of residence, where the tiebreaker clauses in Art. 4 of the Model (and of double tax conventions) have failed, is one of the most common situations where the MAP is invoked.

¹⁰⁷ *Id.* at 144, where the Authors stress that it is not unusual for a MAP to take between 8 and 10 years to be concluded.

¹⁰⁸ Communication (2011) 712 final, Double Taxation in the Single Market, at 9-10.

¹⁰⁹ See *e.g.*, double tax conventions between France and UK (19 June 2008), between the Netherlands and UK (26 September 2008) and between Germany and UK (30 March 2010).

conventions dealing with companies' tax residence would need to be amended accordingly. Double tax conventions amended in this manner could set out the place of the closest economic ties as a tiebreaker criteria, while leaving the place of effective management as a second and residual criteria, to be used only in the case of those companies, such as holding companies, whose activity could not lead to genuine economic integration in the host country. Along with the amendment of residence provisions of double tax conventions, at that time Directive 2011/16 on administrative cooperation between Member States,¹¹⁰ due to be introduced by Member States by 1 January 2013, could also be amended to serve as instrument for transmitting information about the location of the place of the closest economic ties.

Art. 8 of the Directive currently provides for automatic exchange of information about specific categories of income obtained in a Member State by natural persons who are resident in another Member State. From 1 January 2014 onwards, Art. 8 will allow the a State to annually receive information about specific income received by its resident individuals in any EU source State. However, in the current version, Art. 8 does not cover profits earned by companies. Nevertheless, the “place of the closest economic ties” could be expected, at least for companies which are active in the industrial and commercial sectors, to be the place where they have a physical presence and where, thanks to this presence, they also have the closest relations in terms of suppliers and customers. In other words, the “place of closes economic ties” would be the place where a company's business activity in terms of production and commercialization is carried on and where most of its profits are obtained. Moreover, the physical presence in terms of premises, staff and equipment for carrying out the core business activity in a specific country would reflect, under the OECD definition of permanent establishment (PE),¹¹¹ at least the presence of a PE (should the company at stake be regarded as resident in another Member State under the currently adopted criterion for determination of the tax residence). The PE is defined in Art. 5 of the OECD Model (and of double tax conventions based on it), as a fixed place of business, through which the business of an enterprise is wholly or partly carried on. Its presence is relevant because - under double tax conventions provisions based on the OECD Model, it would attribute to the State of location of the PE the right to tax the profits (as a “source country”) earned by the PE itself in its jurisdiction.¹¹² In turn, this taxation right of the country of location of the PE would lead the profits obtained by the company in that country, through the PE, to be subject to reporting obligations there. If most of the company's business activity were carried on, and most of its profits were obtained, in the

¹¹⁰ Council Directive 2011/16/EU on 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, in OJ L 64/1 of 11 March 2011.

¹¹¹ This definition is laid down by Art. 5 of the OECD Model and of double tax conventions based on this Model and includes, as illustrative examples, an office, a factory *etc.*

¹¹² Art. 7 of the OECD Model, replicated in double tax conventions based on it.

country where the PE is located, this country would also be the place of the closest economic ties. Accordingly, in situations where a company's decision-making center and its place of the closest economic ties are located in different Member States, the country where the closest economic ties were located would have this information available. It should thus be able to transmit this information to the country of location of the decision-making centre, and to claim tax residence at the time of this transmission of information itself, on the ground that the economic interests of the company are concentrated in its jurisdiction.

To ensure the smooth application of the place of the closest economic ties as a new connecting factor for corporate tax residence determinations, Art. 8 of Directive 2011/16 could be amended to include, within the scope of provisions covering the automatic exchange of information, the obligation to transmit information concerning companies' profits obtained in the country where most of the business activity is carried out.

In the current version of Art. 8 of the Directive, the automatic transmission of information takes place from the source country to the residence State (implicitly, to the State regarded as residence State under current double tax conventions), without the source State making any claim to residence irrespective of the proportion of the overall taxpayers' income obtained in its jurisdiction. By contrast, in an amended version including companies' profits, the source State, upon being able to indicate that it is the "place of the closest economic ties" of the company, would claim tax residence at the time of transmitting information to the State which was regarded as residence State up to that time on the basis of the (former) "place of effective management criteria".

In this way, the identification of the "place of the closest economic ties" as a connecting factor for companies' tax residence would become possible on a yearly basis, thereby making this new connecting factor for tax residence easy to apply and therefore promoting the aim of legal certainty, in addition to being consistent with the purpose of the freedom of establishment. Lastly, the adoption of the place of the closest economic ties as a new connecting factor for tax residence in bilateral double tax conventions between Member States (and, thus, within the EU) would not be inconsistent with the decision to maintain the place of effective management as a tiebreaker rule in double tax conventions between any Member State and any *extra-European* country,¹¹³ which are mostly based either on the OECD Model¹¹⁴ or on the UN Model Tax Convention.¹¹⁵ In fact, the objective of the

¹¹³ This choice nowadays appears to have started to be called into question anyway: *e.g.*, the double tax convention between Italy and the USA, in Art. 4, does not indicate the place of effective management as a tiebreaker rule, but simply states that, if a company is regarded as tax resident by both contracting States under their domestic law, tax residence is allocated via an agreement between the authorities of the two countries. See the Convention against double taxation between the USA and Italy (1984), Art. 4(3).

¹¹⁴ When entered into with developed countries.

freedom of establishment in terms of genuine economic integration, which suggests a rethinking of the connecting factor for corporate tax residence exactly because of the need for consistency between the connecting factor and the economic integration goal¹¹⁶, only applies within the EU and between the EU and the other EEA countries (which are bound to apply EU fundamental freedoms).¹¹⁷

A rethinking of the connecting factor in a double tax convention between an EU Member State and an extra-European country could be made appropriate anyway by technological developments as shown in paragraph C118, but would not be required by the objective of a superior legal order because no Treaty comparable to the TFEU (and therefore no provision having an economic integration objective such as that of the freedom of establishment granted by Arts. 49 and 54 of the TFEU) exists between an EU Member State and an extra-European country.

However, within the European internal market, the need for consistency with the objective of the freedom of establishment is the key element that would justify any choice to change the connecting factor to the place of closest economic ties. Such a change is further justified by all the circumstances causing the place of effective management criteria to become increasingly obsolete.

E. Conclusions

As shown in paragraph B, above, the general EU law principle of prohibiting abusive practices, especially as applied by the ECJ to assess national laws restricting fundamental freedom, constitutes the criterion for examining the potential incompatibility of any national anti-avoidance provisions of any Member State in the direct taxation area with the freedom of establishment.

As a result, to the extent that provisions on corporate tax residence taking “the place of effective management” as a connecting factor could be regarded as having an anti-

¹¹⁵ The UN Model Tax Convention, developed in 1980 and (just like the OECD Model) periodically updated, serves as a reference for double tax conventions between developed and developing countries, and, in its Art. 4, indicates as a tie-breaker rule for corporate tax residence the place of effective management, like the OECD Model. See United Nations Model Double Tax Convention between Developed and Developing Countries, Art. 4(3).

¹¹⁶ As argued *supra*, in paragraphs C. II and C. III.

¹¹⁷ Notably, the EEA countries are bound to apply EU fundamental freedoms, and thus the freedom of establishment too, by the EEA Agreement (Art. 31).

¹¹⁸ See *supra*, in paragraph C.III, the argument concerning the modern, computerized economy and the awareness shown by the OECD about the impact of technological developments.

avoidance purpose – which certainly holds true in light of the historical origin of this connecting factor – these national provisions are compatible with the freedom of establishment only when they target wholly artificial arrangements. In other words, the application of this connecting factor is compatible with the freedom of establishment when it is aimed at countering outbound transfers or the setting up of companies abroad that do not result in a genuine economic integration in the host Member State, thereby meeting the requirement which was indicated by the European Commission's communication on the coordination of anti-abuse measures.¹¹⁹

It follows that the use of “place of effective management” as a connecting factor—even if called into question at the OECD level itself as early as the start of the current millennium—would still be fully justified under the ECJ caselaw on abuse of rights *in some specific situations*, i.e. in case of mere holding companies set up in another Member State *and* lacking a genuine economic integration in this State. Conversely, in other situations which result in companies' genuine economic integration in the Member State of destination, the concept of abuse of right emerging from the ECJ caselaw and its application to the exercise of the fundamental freedom of establishment *does not justify the continuing application of the “place of effective management” connecting factor*. Instead, the ECJ case-law provides a good reason for a rethinking of the connecting factor for corporate tax residence leading to the choice of the “place of the closest economic ties” – one of the alternatives considered by the OECD— *as a new connecting factor* to be used as tiebreaker rule. The place of closest economic ties, due to its being based on objectively verifiable elements, would be easier to ascertain by third parties (and by tax authorities) than the place of effective management, the latter of which appears destined to become obsolete in the modern computerized economy and distance communication environments. Moreover, as argued above, the place of closest economic ties could be applied via an amendment of Directive 2011/16 on administrative cooperation between Member States.

As a defense of the use of the “place of effective management” as a connecting factor, one might perhaps submit that, because the general principle of prohibition of abuse of rights is the same in all areas,¹²⁰ the concept of tax residence should also be the same. This argument might be supported by noting that the entire *acquis communautaire* ultimately has the same objective of market integration. Nonetheless, it could be objected that—in achieving this ultimate and common goal—different provisions in different areas have their own specific purposes, which, in order to supplement each other, must be different from each other. The fundamental freedoms in general, and the freedom of establishment in particular, have a specific purpose which is different from the particular purposes of VAT and indirect taxation legislation. Whereas the specific purpose of the freedom of establishment is a genuine economic integration in the host Member State, the specific

¹¹⁹ COM (785) 2007 final.

¹²⁰ *Id.* at para. B, II.

purpose of VAT and indirect taxation legislation is to contribute to an efficient single market for goods and services within the EU by setting up a neutral and transparent turnover tax system.

Moreover, whilst the prohibition of abuse of rights is a general principle and as such may have the same general content in terms of improper use of rights granted by EU provisions,¹²¹ its concrete application in different areas involves verifying whether economic agents, in trying to benefit from different provisions, implement operations which run against the specific purpose of the particular provisions at stake from time to time.

As indicated in paragraph C above ¹²², one could raise the issue of whether or not the concepts of tax residence laid down for indirect taxation purposes could also apply within the EU for direct taxation purposes. If the response were in the affirmative, a connecting factor for direct tax residence, given by the company's decision-making center (“place of effective management”), would imply using the same notion of tax residence in the two areas of direct and of indirect taxation. Nonetheless, in so doing, it would ignore the purpose of a fundamental freedom and may dissuade taxpayers from exercising it. This problematic issue can be definitively solved only if the ECJ were given the occasion to decide whether the use of the place of management criteria as connecting factor for corporate residence in direct taxation would be compatible with the Treaty's provisions. Up to the present, unlike the case law on abusive practices, the case law on indirect taxation, if taken together with the direct tax rulings concerning the exercise of the freedom of establishment, does not seem to offer evidence that the same notion of tax residence applies in the two areas of direct and indirect taxation. As already noted, references in the EU corporate tax Directives, and in some ECJ rulings, to national definitions of tax residence and to Member States' freedom to allocate taxing powers according to double tax conventions, are also irrelevant in this respect, because these references merely reflect the lack of a uniform connecting factor for corporate tax residence in current EU tax law. This can only mean that the issue of the consistency of the place of effective management connecting factor with the freedom of establishment has not yet been raised.¹²³

Therefore, if the national provisions on tax residence reflecting the place of management criteria were challenged before the ECJ and found to be in breach of the right of establishment, this could give renewed impetus (at least within the EU) to a rethinking of the connecting factors to be used as a tiebreaker rule for companies' tax residence. Such a ruling could also drive changes in the national rules on tax residence on behalf of all

¹²¹ As illustrated *supra*, in para. B, II.

¹²² See *supra* para. C, II.

¹²³ *Id.*

Member States whose provisions on the connecting factor for tax residence could potentially be found in breach of the freedom of establishment.

In so doing, this ruling could induce Member States to coordinate with each other in exercising their fiscal competence for designing rules relating to direct taxation in order to make these rules more consistent with each other and more consistent with the goal of the freedom of establishment. Such a coordination in (re)shaping tax residence rules would be fully in line with the objective of ensuring that national direct tax systems work together properly to the benefit of all (corporate) taxpayers with cross-border business activity, which objective was indicated by the European Commission in a 2006 Communication on "Co-ordinating Member States' direct tax systems in the internal market."¹²⁴

¹²⁴ Communication COM (2006) 823 final, at 4. On this Communication, among others, Adam Zalasinski, Franco Roccataliata, *A Community action to facilitate the co-ordination Members States' tax systems. The Communication of the Commission "Coordinating Member States' direct tax systems in the Internal Market": A newstep on the strategy of co-operation between the European Commission and the Member States* Un' azione comunitaria per agevolare il coordinamento tra gli ordinamenti fiscali degli Stati membri 1 RIVISTA DI DIRITTO TRIBUTARIO INTERNAZIONALE 1, 193-202 (2007); Pietro Selicato, *La Common Consolidated Corporate Tax Base (CCCTB) tra esigenze di armonizzazione della imposta sulle società e profili di compatibilità con gli ordinamenti nazionali*, in 2 RIVISTA DI DIRITTO TRIBUTARIO INTERNAZIONALE 161, 167-169 (2009).